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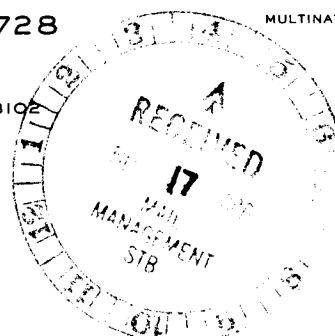
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November 17, 2000



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Mr. Vernon A. Williams
Secretary, Surface Transportation Board
1925 K Street, N.W., 7th Floor
Washington, D.C. 20423

Re: Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures

Dear Secretary Williams:

Enclosed are the original and 25 copies of the "Opening Comments of Edison Electric Institute" for filing in the above-referenced proceeding, and a diskette containing the Comments in WordPerfect format.

Also enclosed are three additional copies for date stamping and return via our messenger.

Very truly yours,

Michael F. McBride
Michael F. McBride

Attorney for Edison Electric Institute

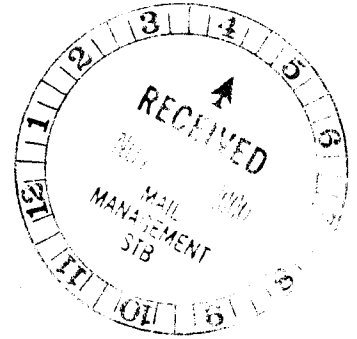
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cc: All Parties of Record

200449

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)



MAJOR RAIL CONSOLIDATION PROCEDURES

OPENING COMMENTS OF EDISON ELECTRIC INSTITUTE

ENTERED
Office of the Secretary
NOV 17 2000
Part of
Public Record

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Due Date: November 17, 2000

Dated: November 17, 2000

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

OPENING COMMENTS OF EDISON ELECTRIC INSTITUTE

INTRODUCTION AND SUMMARY

Edison Electric Institute ("EEI") is encouraged that the Board proposed changes in its railroad consolidation policy to enhance competition, assure adequate service, and require that benefits of proposed railroad consolidations be demonstrated with greater assurance. The proposed policy changes, if implemented through specific rules that assure that competition would be enhanced and that adequate service would be maintained, are appropriate policy, especially given the results of the last several railroad consolidations. However, EEI is concerned that the proposed rules themselves would not actually assure that the Board's stated policies would be carried out.

The proposed rules would appear to permit any conceivable Class I railroad merger, acquisition, or control transaction so long as the application satisfies the informational requirements the Board is also proposing. In each of the last several consolidation proceedings, after all, the applicant carriers have contended that the transaction in question would enhance competition, assure adequate service, and produce demonstrable public benefits. The Conrail acquisition by CSX and Norfolk Southern was only the latest example of such claims, but of course the claimed benefits of, say, taking one million trucks off the highways, have not materialized, and service is worse instead of better.

Given the public statements of Canadian Pacific Railway, CSX Transportation, Norfolk Southern Railway, and Union Pacific Railroad that they objected only to the timing of the proposed Burlington Northern-Santa Fe Railway/Canadian National Railway merger,¹ it must be assumed that the first merger transaction announced after the Board's new rules take effect will trigger other mergers. Based on recent history, as well as on public statements, we can expect that the relentless pace of major rail consolidations will continue, even if the exact timing is not clear. One might expect that the Class I railroads with service problems or low stock prices will want to wait, but if, for example, BNSF and CN were again to announce a merger, other such mergers would almost certainly occur, regardless of the state of service in the industry, and regardless of the financial condition of the other Class I railroads. After all, Union Pacific now claims its service problems are behind it, and so have NS and CSX more recently. The prerequisite for further consolidations that CP, CSX, NS, and UP set out in their "Open Letter to Railroad Customers" has thus been satisfied, and they presumably would instruct their counsel to draft an application which they would contend would satisfy the Board's proposed rules if the right transaction opportunity presented itself. EEI must therefore presume that the relentless pace of rail mergers will continue and that the STB must make the same presumption.

The new merger² rules must therefore have the "teeth" to enhance competition, assure adequate service, and require demonstrable public benefits. As of now, the proposed rules do not have the "teeth" needed to assure that these objectives will be met. EEI is particularly distressed that

¹ See "Open Letter to Railroad Customers," January 11, 2000 in The Wall Street Journal, among other publications.

² For convenience, we use "merger" to mean merger, acquisition, or control, i.e., any form of railroad consolidation proceeding involving Class I railroads.

it proposed several such specific conditions in its Comments in response to the Board's ANPR, but for the most part they were not proposed by the Board. Even the one that was, open gateways, was not accompanied by a necessary condition, that the gateway be open economically as well as physically, to make the condition meaningful. This issue is particularly important because mergers of each of the two the western U.S. Class I railroads with each of the two eastern U.S. Class I railroads could otherwise make it essentially impossible for the Dakota, Minnesota & Eastern Railroad ("DM&E") to compete with UP and BNSF for transportation of western low-sulfur coal to the Midwest and the East.

Moreover, the Board did not propose to protect shippers from increases in rates and charges after a merger, it did not propose to prevent railroads from passing through acquisition premiums paid in such transactions, it did not propose to use the full extent of its authority to compel terminal trackage rights, it did not say it would protect "3 to 2" shippers from loss of competition, and it did not propose compensation to shippers for inferior service as a result of a merger, among other such proposals. EEI again urges the Board to propose specific rules that would become conditions of any approvals of Class I rail mergers that would assure shippers and smaller railroads that they would be protected as a result of such transactions. EEI contends that the Board is required to respond to important comments submitted to it in its final rules.

THE VIEWS OF EEI ON THE ANPR.

The comments of EEI on the ANPR were quite specific. Rather than repeat verbatim what EEI proposed, we hereby refer the Board to EEI's comments on the ANPR, and urge the Board to address them specifically. EEI is concerned that the Board has not responded to its specific suggestions, which may imply that the Board does not agree with them. However, this

is not clear. EEI urges the Board to respond to the important comments made by each party, which the Administrative Procedure Act requires. *E.g., American Mining Congress v. EPA*, 907 F.2d 1179, 1188 (D.C. Cir. 1990), *citing ACLU v. FCC*, 823 F.2d 1554, 1581 (D.C. Cir. 1987), *quoting Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 n.58 (D.C. Cir. 1977), *cert. denied*, 485 U.S. 969 (1978).³

THE VIEWS OF EEI ON THE NPR.

In its proposed rules, the Board said that it would ensure that future rail mergers will enhancing competition, assure adequate service, and require that the demonstrated benefits of a proposed transaction be more certain. While EEI endorses those policy objectives, EEI is concerned that the Board's proposed rules do not assure that those outcomes will be achieved. In fact, in most if not all recent mergers, the Applicants have claimed that the transaction in question would achieve, and there is nothing in the proposed rules that would demonstrate that those claims would not be accepted.

The Board also indicated that it would no longer issue informal opinions approving voting trusts, but rather those would be approved only by the Board itself, rather than by its Secretary. EEI supports that change. Surely, if the Board had considered whether to allow CSX and NS to spend most of the money they spent to acquire Conrail before they spent it, rather than after, as the Board did in Finance Docket No. 33388, and knew then what it knows now, it might well have agreed with the comments of certain EEI members that it should not have allowed those expenditures. The current financial woes of CSX and NS can be directly traced to their acquisition of Conrail.

³ The Board summarized parties' comments in an Appendix to the NPR. But that, while useful, is not what is needed to satisfy the APA; the APA requires that the Board respond to the important comments, as the cited authorities hold.

But the Board adopted almost none of the specific proposals made by EEI or other shipper interests on the ANPR, nor did it propose any specific, "bright-line" rules, except ones procedural in nature, that were proposed by other parties, including rail labor and short lines.

We are thus faced with a dilemma -- may we rely on the Board's generalized assurances that it will enhance competition, assure adequate service, and require a more definite and certain showing of benefits before it will approve a merger? Or are we to read into the proposed rules a rejection of the specific suggestions that were made by various parties?

Unfortunately, it is not likely that we can assume the best from the rules themselves, even if we can assume the best about the Board's intentions. That is because, even given the best intentions, the proposed rules would permit any conceivable remaining rail merger.

BNSF and CN, after all, contended that their proposed merger would enhance competition, assure adequate service, and provide a more certain and substantial showing of public benefits. So one would have to assume that those two rail carriers could make the showing the Board's proposed rules require, and be approved. If so, the Board's refrain about "balanced competition" would almost compel the approval of the remaining mergers necessary to keep the remaining carriers of approximately equal size to a merged BNSF-CN. It is therefore clear that the process would inevitably lead to two major railroads in North America. The only question is "when?"

The rules, therefore, actually provide the Board with greater discretion than before, and produce greater uncertainty as to when mergers will occur and what conditions the Board will impose on them.

But the greatest problem with the proposed rules is that the Board made clear that industry-wide measures to promote competition in the railroad industry⁴ are not for the Board to consider, but rather are for Congress. NPR at 16-17. One thing is therefore clear: the Board is not going to lead the effort to adopt industry-wide solutions to the problem of lack of competition in the rail industry. Make no mistake, the Board could do so if it wished. It could, for example, repeal the infamous MidTec decision, which has prevented any shipper from obtaining relief under the terminal trackage rights provision of the statute, but the Board has not proposed to do that. Apparently, such remedies will have to come from Congress.

Beyond industry-wide solutions, the proposed rules will almost certainly lead to one of two unpalatable alternatives: either no mergers, and a continuation of the status quo, or one merger leading to another and another, to maintain what the Board has called "balanced competition," with the inevitable result that there will be only two Class I railroads in the United States, or even in all of North America. Shippers regard either alternative as undesirable.

For that reason, the shipping community will seek legislation in the next Congress. EEI does not further address those matters in these Opening Comments, as the Board has made it clear that it considers them outside the scope of this proceeding.

EEI offers the following comments on the proposed rules:

1. **Bottleneck Rates.** Contrary to some reports, as EEI reads the proposed rules the Board in the NPR proposed no change in its "bottleneck" rate decisions. All the Board appears to have said is that, if a shipper has a contract rate over the "non-bottleneck" carrier before a merger, it will

⁴ The Board referred to proposals for industry-wide relief as "open access," even though most shippers have taken pains to say that they are not advocating that remedy.

require a separately published rate over the "bottleneck" segment after a merger. The only shipper which has achieved those circumstances, even without a merger, is FMC Corp. Its circumstances were somewhat unique, as it obtained contracts outside the West, then challenged "bottleneck" rates only in the Western territory. Also, its case developed during the "bottleneck rate" litigation. It is not likely that the situation in the FMC proceeding will recur.

As the Board knows, shippers are not satisfied with the "bottleneck rate" decisions of the STB, and will continue to urge Congress to amend the statute to grant the Board power to compel railroads to publish "bottleneck rates" so that either the competition that then can occur over the non-bottleneck segment will occur, as shippers believe Congress intended in the Staggers Rail Act of 1980, or as a last resort a shipper can challenge the "bottleneck rate" at the STB. Otherwise, mergers can create larger and larger monopolies without regulatory action to assure that competition that can occur will occur. But we understand that the STB considers itself not to have the authority to compel the publication of "bottleneck" rates, except where the contract exception applies, so EEI will not belabor the point here.

In the merger context, the Board acknowledged in the NPR that it has broad powers to adopt conditions in mergers to protect the public interest. It follows that the Board could adopt conditions requiring the merging railroads to offer "bottleneck rates" wherever they are the only carrier to serve a particular shipper. That would enhance competition over the "non-bottleneck" segments. The best ways to avoid such legislation would be for the Board to adopt a changed interpretation of the statute, or at least to adopt such a condition in any subsequent merger. Since each of the Nation's Class I railroads is likely to be involved in at least one more merger, such a condition would

ultimately resolve the problem. (It is clear under the D.C. Circuit's merger moratorium decision that the Board could not indefinitely preclude parties from filing merger applications.)

2. Terminal Trackage Rights. The Board's decision in MidTec to require a shipper to show "competitive harm" before the terminal trackage rights provisions of the statute could be invoked was not compelled by the language of the statute. Indeed, the Board applies the same provision in merger proceedings without requiring a showing of "competitive harm," but typically where a competing railroad is involved, rather than for a shipper. Thus, for example, the Board may order trackage rights under this provision to make the merging railroad more efficient, but will not apply the same rationale where the shipper seeks relief. Certainly, the Board cannot argue that its MidTec decision cannot be overruled, but it continues to decline to do so, without saying why. But shippers have concluded that the Board will not do so of its own volition. Therefore, and because shippers believe Congress intended that the "terminal trackage rights" provision be applied generally and without being limited only to those situations in which the shipper could prove "competitive harm," shippers will seek relief from Congress.

3. Elimination of "Paper" and "Steel" Barriers. Many parties argued that shortline and regional railroads could play a significant role in certain circumstances in maintaining or enhancing competition, if only the Board were to outlaw "paper" barriers, at least prospectively. But the Board did not. The Board declined, as in other respects, to provide assurance that it would rely on such alternate carriers for relief in defined situations, even though the Board recognized that shortline and regional railroads could be a competitive option. The Board did not indicate that it would require the restoration of physical connections that railroads have obstructed with "steel" barriers.

When the Board fails to make clear its intention to provide alternate carriers with the ability to provide competition, it discourages them from participating in merger proceedings to seek such relief, because the cost of participation in such proceedings is substantial. The Board should make clear its intention to provide such a remedy a requirement in appropriate circumstances.

4. **Service Standards.** As it now stands, rail carriers either pay no penalty at all in many such circumstances of inadequate service, or, even worse, charge increased rates or charges to make up for any lost profit. While a few shippers have sued for loss of contractually agreed minimum levels of service, we are not aware of reported cases establishing obligations of railroads to pay damages for inadequate service for tariff shippers. The Board should establish a framework for measuring such damages, and a clear obligation on the part of the railroads to pay such damages, in the event that service declines after a merger.

EEI is particularly frustrated that the Board suggested that the merging railroads propose their own service standards and penalties for failing to meet them. A right without a remedy is no right at all, and at this time it would appear that shippers have no remedies for inadequate service unless their contracts provide for one. The Board will not have done all that it can do to assure adequate service unless it imposes financial penalties on railroads who fail to provide appropriate service as a result of a merger.

5. **Open Gateways.** Here, the Board did indicate with some specificity that it is likely not to allow open gateways to be closed. But even in such circumstances, the Board did not acknowledge that unless it acts to ensure that a gateway can be economically kept open, it is not truly "open." Even such parties as Union Pacific urged the Board to keep gateways economically as well as physically open. Most gateways which could be closed have been closed, so the Board's new

policy may be of little practical value. The Board should act to ensure that mergers will not cause gateways to be closed, economically or physically, with the only conceivable exception being that there are compelling circumstances requiring their closure.

EEI is particularly concerned about this issue because the fate of the DM&E may depend on it. DM&E intends to transport coal to railroads other than UP and BNSF, such as the Illinois Central, I & M Rail Link, and through them, to CSX and NS, in competition with UP and BNSF. If UP and BNSF each merge with one of the two eastern Class I railroads, DM&E will not be able to compete absent protection of its existing gateways. If it is likely, as many appear to believe it is, that there will only be two Class I railroads in the United States before too long, then it is essential that the Board adopt a policy that would ensure that railroads such as the DM&E, who can provide much-needed competition in certain regions, be protected from the effects of such transcontinental mergers.

6. **"3 to 2" Shippers.** Most economists insist that two competitors are not enough to assure competition. The evidence suggests that two potential competitor railroads may collude, or settle into a comfortable "dual monopoly" situation, while three competitors create far greater uncertainty that such understandings may hold, and thus result in a more competitive outcome. Where there are three competitors, the Board should ensure that three competitors will remain.

7. **"One-Lump" Theory.** In any future merger proceeding, shippers will likely argue that a rail merger that extends a railroad's geographical reach extends its monopoly power, requiring a remedy, and that reliance on the "one-lump" theory would be mistaken. The Board should make clear that it will take a more active role in determining whether the evidence supports the theory, including requiring the Applicants to provide evidence necessary to test whether the theory applies.

8. **Acquisition Premiums.** The Board has an affirmative duty to protect customers, especially captive customers, from increases in rates and charges, especially where acquisition premiums have been paid. Other agencies provide such protection. The Board should decide now to provide such relief, and ask the Second Circuit for a voluntary remand of this issue in the pending Conrail appeals. This issue is important not just to shipper interests. Merging railroads would be better served if the Board's rules clearly provided that they will not be allowed to pass such premiums on to their customers. Mergers would then likely include only smaller premiums that the merging railroads could absorb, or none at all (using stock swaps instead, as have some recent transactions).

9. **Single-Line Service.** FERC and other agencies attempt to ensure that merging companies do not cause harm to any customer due to a merger. The STB should do likewise. Where mergers cause shippers to go from single-line to two-carrier service, it should either adopt conditions to prevent that, or, at a minimum, require that the carriers guarantee, under pain of financial penalties, that service not deteriorate after a merger. Customers, especially captive customers, should not be required to bear the brunt of the service failures that are caused by mergers that they had no part in encouraging.

10. **ADR For Service Failures.** EEI is aware that the Board has a new "hot line" for service complaints. EEI proposes that the Board formalize the process somewhat, for shippers who so desire. EEI proposes that merging railroads agree, as a condition of approval of the transaction, that they will participate in shipper-initiated arbitration, mediation, or negotiation in which the shipper asserts that it has suffered from worse service as a result of the merger. The Board could, in this fashion, provide shippers with some assurance that their grievances might be expeditiously

addressed, by some professional who presumably has the time to do so promptly, in a confidential setting if that is what the shipper desires. EEI is willing to allow the railroads to suggest procedures that they believe would make this process fair. EEI anticipates that reply comments will allow the Board to get sufficient information from the parties to adopt final rules in this proceeding to assure shippers that such ADR processes will provide an effective and efficient process for resolving service disputes.

CONCLUSION

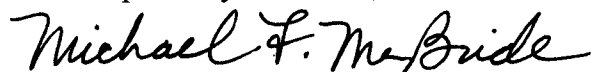
The proposed rail merger rules are an improvement in the sense that the Board has acknowledged that prior mergers have harmed competition, impaired service, and not produced the public benefits that were supposed to result from them. The proposed rules, nevertheless, are not adequate. They are not adequate because they are not specific, making it unclear whether the comments of parties such as EEI were accepted or rejected, leaving almost totally to the Board's discretion whether a proposed merger would satisfy the Board's policies. Moreover, under the Administrative Procedure Act, the Board has an obligation to respond to important comments which, thus far, it has not done.

Many, if not all, parties desire greater certainty about the new merger rules so that they may make an intelligent choice whether to participate in a merger proceeding and so as to reduce the costs of participation if they do intervene. In any event, without industry-wide policy changes to promote rail-to-rail competition, the Board's proposed rules almost certainly will produce one of two undesirable outcomes: either a continuation of the status quo with rail competition and degraded service, or only two major railroads in all of North America -- which, if possible, may be even worse than the status quo.

The Board simply has chosen not to grapple with broader issues of industry-wide concern, whether in this proceeding or in other proceedings, leaving shippers no choice but to pursue legislative remedies for these problems. Shippers are emphatically of the view that the industry-wide issues of lack of competition or adequate regulatory remedies are more important than whether to allow the Class I railroads to consolidate. Yet the Board has made revision of its consolidation rules its highest priority, instead of industry-wide relief.

Because future rail mergers remain not only permissible, but likely, EEI believes the Nation is headed to a future of two Class I railroads in North America. Such a future makes the need for rail-to-rail competition more and more urgent. The Board could promote that goal in this proceeding, and EEI urges it to do so to the maximum extent that it believes its statutory authority permits. EEI has identified a variety of specific proposed rule changes that would assist in accomplishing that objective, and once again urges the Board to adopt its proposals.

Respectfully submitted,



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Due Date: November 17, 2000
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I hereby certify that on this 17th day of November, 2000, I have served copies of the foregoing "Opening Comments of Edison Electric Institute" on the following persons by first-class mail:

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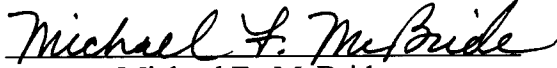
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